

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition	:	
of	:	
SPARTAN COFFEE SHOP, INC.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period December 1, 1981	:	
through February 28, 1985.	:	

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DETERMINATION

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In the Matter of the Petition	:	
of	:	
JOHN ZAHARIS,	:	
OFFICER OF SPARTAN COFFEE SHOP, INC.	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29 :	:	
of the Tax Law for the Period December 1, 1981	:	
through February 28, 1985.	:	

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Petitioner Spartan Coffee Shop, Inc., 1470 Second Avenue, New York, New York 10021, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1981 through February 28, 1985 (File No. 802800).

Petitioner John Zaharis, Officer of Spartan Coffee Shop, Inc., 87-23 168th Street, Jamaica, New York, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1981 through February 28, 1985 (File No. 802801).

A consolidated hearing was held before Robert F. Mulligan, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on December 11, 1987 at 10:00 A.M., with all briefs to be submitted by January 15, 1988. Petitioners appeared by James Vittas, CPA. The Audit Division appeared by William F. Collins, Esq. (Gary Palmer, Esq., of counsel).

ISSUE

Whether an observation test properly determined sales and use taxes due from Spartan Coffee Shop, Inc.

FINDINGS OF FACT

1. Petitioner Spartan Coffee Shop, Inc. ("the corporation") operates a restaurant at 1470

Second Avenue, New York, New York. Petitioner John Zaharis is president and sole shareholder of the corporation.

2. A sales tax field audit of the corporation's business operations was conducted by the New York District Office commencing in November 1984 and concluding in July 1985. The audit period was December 1, 1981 through February 28, 1985. The audit was conducted as follows:

(a) The auditor requested cash register tapes and guest checks which were not produced by the corporation. Accordingly, books and records were deemed to be inadequate.

(b) The corporation's Federal income tax returns disclosed that:

(i) Salaries and wages for the fiscal year ending September 30, 1982 were \$13,815.00, compensation of officers (John Zaharis) was \$8,320.00 and rent for the fiscal year was \$21,837.37.

(ii) Salaries and wages for the fiscal year ending September 30, 1983 were \$7,800.00, compensation of officers (John Zaharis) was \$8,320.00 and rent for the fiscal year was \$24,266.07.

(c) The auditor was told by the accountant for the corporation that the restaurant was a small, one-man business with "some help in the morning". The auditor visited the restaurant at about 1:45 P.M. on December 18, 1984. He found five people working there, including John Zaharis, and saw that business at the restaurant was "brisk". There were 17 counter seats and 12 other seats with tables. All but four of the seats were occupied.

(d) In view of the above, the auditor and his supervisor determined that an observation test of the business was appropriate. Observation was conducted as follows:

(i) Observation of the business was made on March 5, 1985 from 6:25 A.M. until 4:00 P.M. Sales to 12:30 P.M. were \$618.80. Total sales for the day were \$882.93.

(ii) Petitioners objected to the results of the first test, claiming that the sales were too high. Consequently, the auditor agreed to make another observation from early in the morning until 12:30 P.M., as most sales took place between 6:30 A.M. and 12:30 P.M. The second test was performed on May 24, 1985 when sales to 12:30 P.M. were determined to be \$641.29.

(iii) The auditor used the March 5, 1985 figures (as they were lower) and, after allowing for sales tax deemed to be included, calculated net daily audited sales of \$815.70. This figure was multiplied by 6½ days per week for 13 weeks per quarter for 13 quarters arriving at \$896,047.00 in adjusted sales and tax of \$73,923.88. Taxes reported were \$22,842.00 resulting in additional tax due of \$51,081.88.

(e) No allowance was made for inflation, as the auditor learned that the menu in use by the restaurant at the time of the tests had been printed in 1981. The restaurant also used a wall menu and the prices listed thereon are contained in the audit workpapers. It is unclear, however, how the wall menu prices compared to the printed menu prices.

3. On September 11, 1985, the Audit Division issued similar notices of determination and

demands for payment of sales and use taxes due to the corporation and to petitioner John Zaharis, as officer, in the following amounts for the period December 1, 1981 through February 28, 1985: tax due \$51,081.88; penalty \$11,089.62; interest \$14,422.12; total due \$76,593.62.

4. The corporation showed a net operating loss on its Federal income tax returns for all of the fiscal years 1976 through 1982. For fiscal 1983 it showed taxable income before net operating loss deduction of \$2,960.14 and utilized a net operating loss deduction of the same amount to arrive at "zero" taxable income.

5. In 1982 and 1983 petitioner John Zaharis had income from sources other than the corporation as follows<sup>1</sup>:

1982

Dividends	\$33,074.00
Rental income	3,515.00
Capital gains	<u>7,122.00</u>
Total	\$43,711.00

1983

Dividends	\$34,000.00
Rental income	3,300.00
Capital gains	<u>12,000.00</u>
Total	\$49,300.00

6. An analysis was performed by petitioners' accountant in conjunction with the hearing. The accountant started with the \$36,136.00 in sales reported on the sales tax return for the quarter in which the observation test was performed and divided said figure by 84½ days (13 weeks x 6½ days per week) arriving at average daily sales of \$427.64. As the net sales per the observation test were \$815.70 per day, additional taxable daily sales for said quarter were \$388.06. The accountant thus concluded that there was an error ratio of 90.74 percent<sup>2</sup>. Applying said percentage to taxable sales reported for the audit period of \$275,541.00, the accountant arrived at additional taxable sales of \$250,025.90 and additional sales tax of \$20,627.13.

7. Petitioners did not contest petitioner John Zaharis's status as a person required to collect

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<sup>1</sup>Petitioners' representative submitted a copy of a Decree on Accounting filed in the Bronx County Surrogate's Court on February 19, 1985 ostensibly to show that petitioner John Zaharis was the beneficiary of a sizeable distribution from his father's estate. While the decree does not show precisely that, it does show that petitioner John Zaharis was a co-executor under the will of Atha Zaharis a/k/a Tom Zaharis and that the estate had assets of over \$1 million.

<sup>2</sup>\$388.06 divided by \$427.64 = .9074

tax on behalf of the corporation.

### CONCLUSIONS OF LAW

A. That Tax Law § 1138(a)(1) provides, in pertinent part, as follows:

"If a return required by this article is not filed, or if a return when filed is incorrect or insufficient, the amount of tax due shall be determined by the tax commission from such information as may be available. If necessary, the tax may be estimated on the basis of external indices, such as stock on hand, purchases, rental paid, number of rooms, location, scale of rents or charges, comparable rents or charges, type of accommodations and service, number of employees or other factors."

B. That where a taxpayer's records are incomplete or insufficient, the Audit Division may select a method reasonably calculated to reflect the sales and use taxes due and the burden then rests upon the taxpayer to demonstrate by clear and convincing evidence that the method of audit or amount of tax assessed was erroneous  
(Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858).

C. That the records of Spartan Coffee Shop, Inc. were incomplete and insufficient in that no cash register tapes or guest checks were available for audit. Accordingly, it was proper for the Audit Division to estimate taxes based on observations of the business. However, allowance should have been made to reflect lower prices which generally prevailed in the years prior to the year in which the audit was actually conducted, i.e., 1985.<sup>3</sup> Accordingly, audited taxable sales for the period December 1, 1981 through May 31, 1982 are to be reduced by 15 percent; the sales for the period June 1, 1982 through May 31, 1983 are to be reduced by 10 percent; and the sales for the period June 1, 1983 through May 31, 1984 are to be reduced by 5 percent. Sales for the balance of the audit period are to remain unchanged.

D. That except as set forth in Conclusion of Law "C", petitioners have failed to sustain their burden of proof to show that either the method of audit or the amount of tax assessed was erroneous.

E. That the petitions of Spartan Coffee Shop, Inc. and John Zaharis, as Officer of Spartan Coffee Shop, Inc., are granted to the extent indicated in Conclusion of Law "C" but are otherwise denied, and the notices of determination and demands for payment of sales and use taxes due issued on September 11, 1985, as so modified, are sustained.

DATED: Albany, New York

August 25, 1988

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<sup>3</sup>Even though the printed menu in use in 1985 may have been printed in 1981, it is hard to believe that the same prices would have been in effect for four years. If prices had remained the same, they would either have been comparatively high in 1981 or comparatively low in 1985 and volume would obviously have been affected. In any event, the audit method, which utilized total daily sales, makes menu prices irrelevant.

/s/ Robert F.

Mulligan \_\_\_\_\_  
ADMINISTRATIVE LAW JUDGE